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## **Can Audit (still) be Trusted?**

### **Abstract**

This paper analyses audit as an exemplar of an expert system. The paper explores the premise that systemic trust in audit has been damaged and requires repair, looking specifically at the role of the institutionalised mechanism of the public inquiry. This is examined empirically in relation to the interaction between the Heads of the Big Four accounting firms in the UK and the House of Lords Economic Select Committee in the course of the recent parliamentary investigation into the UK Audit market, prompted by the global financial crisis. In particular, the paper seeks to understand how there can be *transfer of trust*, following Sztompka (1999), between different levels and between agents in a system. In this case, the Big Four - as privileged market participants - require re-legitimation from agents that are part of the political and legal apparatus. We therefore argue that re-legitimation of the Big Four's privileged market position is dependent on transfer of trust.

**Key words:** trust, accountability, audit, expert systems, Big Four, financial crisis, transfer of trust.

## **Can Audit (still) be trusted?**

“Audits of various sorts come to replace the trust that social government invested in professional wisdom and the decisions and actions of specialists.”  
(Miller & Rose, 2008: 110)

“Financial magicians went from being the objects of public envy to the targets of universal contempt. Politicians became exposed as corrupt and as liars. Governments were denounced. Media were suspected. Trust vanished. And trust is what glues together society, the market, the institutions. Without trust, nothing works. Without trust, the social contract dissolves and people disappear as they transform into defensive individuals fighting for survival”.  
(Castells, 2013: 1)

## **Introduction**

Since 2008, governments, international agencies and the media have sought to understand the causes of the financial crisis and establish ‘who is to blame’ (Davies, 2010). Integral to this process has been an ebbing away of trust in a broad spectrum of actors across the global financial system (Gillespie et. al., 2012; Stiglitz, 2012; Rajan, 2010). This extended in due course to asking critical questions of the Big Four accounting firms that audited the accounts of the major financial institutions that failed. The mistrust pandemic that has engulfed the financial system taps into a broader erosion of trust in institutions found across contemporary society (Misztal, 1996: 3), especially during the last twenty years or so (Kouzes & Posner, 2011: Ch.1). The research question driving this paper is: *how does the expert system of audit justify itself in the light of apparent failure and ensure that, institutionally, audit can*

*still be trusted?* We address this question through an analysis of the interrogation and testimony of UK managing partners of the four major accounting firms – the ‘Big Four’ – in a 2010 House of Lords inquiry into the British audit market. The central contribution of this study is to explore extant understandings of trust repair (Dietz & Gillespie, 2012; Bachmann & Inkpen, 2011; Sztompka, 1999; Kramer & Cook, 2004). Secondly, the study draws on and contributes to the literature on expert systems and trust (Barrett et al, 2005; Barrett and Gendron, 2006; Fogarty et al, 2006; Free 2008; Jeacle & Carter, 2011) and audit failure (Humphrey et al., 2009; Arnold & Sikka, 2001; Power, 1997; Thornburg & Roberts, 2008) respectively. Our approach is a sociological one, which aims to contribute towards an empirically informed analysis of audit, trust and the role of the public inquiry.

Outside of academic concerns on trust, this paper resonates, more generally, with the crisis of trust that many institutions currently face. The number of crises and scandals during say the last fifteen years has “assaulted our confidence in the trustworthiness of the organizational systems on which we rely.” (Kramer & Cook, 2004: 2; cf. Eilifsen & Willekens, 2008: 2-3) The period in which the Lords inquiry took place is perhaps significant for understanding the dataset we draw upon. It followed “a deepening crisis of public trust” (O’Neill, 2002: 8), which in the context of the UK comprised of a scandal over parliamentary expenses, a melt-down in the banking sector, and a phone hacking scandal in the media (see Dietz & Gillespie, 2012). These scandals occurred in a context whereby the framing of news, for instance, by emphasizing negative actor traits, was overwhelmingly hostile and implicated the media in growing cynicism or distrust among the public (Cappella & Jamieson, 1997; Kramer, 2006: 9). An illustration of the ‘mistrust pandemic’ was the public debate at the 2013 Edinburgh International Book Festival: chaired by Gavin Esler, a highly respected BBC journalist, a series of events took place under the header “The Collapse of Trust” with individual sessions focusing on “Can we trust the media?”, “Can we trust each other?”, “Can we trust the government?”, “Can we trust the economists?”

Related concepts of trust, mistrust and the repair of trust go to the heart of the zeitgeist. In the aftermath of the Wikileaks affair, serious questions of data security and privacy, involving Google and other Internet firms, have fuelled major discussions around the extent to which citizens across the world are able to trust their political and corporate leaders. The ‘mistrust pandemic’ is internationalist in its orientation and serious questions of trust in contemporary markets, institutions and society have been debated widely, including in the U.S. (eg Cappella & Jamieson, 1997; Lounsbury & Hirsch, 2010; Kouzes & Posner, 2011; Bohnet

et al., 2012), Germany (Gehrig, 2013; Rosenberger & Seeber, 2013), as well as globally (eg Castells, 2013).

In the U.K., wave upon wave of scandals, ranging from the autism scare, phone hacking, patient neglect in NHS hospitals, Westminster MPs' expenses, encourages us to ask whether the traditionally respected *professions still deserve* or have in fact *lost* our trust. This sensibility is reflected in publications asking whether we can trust the BBC (Aitken, 2008, 2013), trust the media (Monck & Hanley, 2008), trust our leaders (Kouzes & Posner, 2011; Krastev, 2013), trust our fellow citizens, and whether "a revolution in accountability (can) remedy our 'crisis of trust'?" (O'Neill, 2002: 4) In the wake of this general 'crisis of trust', as well as the 2008- financial crisis, the expert system of audit was thus at risk from its critics (Sikka, 2009). Therefore, we commend trust as a central concept to organization theory as it seeks to understand contemporary organizations.

The current crisis in trust is focused not only on certain high profile individuals, but extends to organizations and institutions: firmaments of the establishment that have been undermined by scandal. While individuals – such as high profile bankers - might be scapegoated for their failings and blamed for the collapse of their organizations, the crisis in trust goes much further: it strikes at the heart of 'expert systems', which Barrett et al. (2005, p. 19), in their study of large accounting firms, note "facilitate standardization across contexts and provide a key coordinating function". We argue that expert systems embody "abstract trust in the organizational regimes of coordination, supervision, or leadership that safeguard smooth cooperation" (Sztompka, 1999: 63). We seek to show how the trustworthiness of the Big Four accounting firms' expert systems can be *reaffirmed* or (further) *undermined* at one critical  *juncture*, namely the testimony at a Parliamentary Select Committee inquiry. For this purpose, we utilize Sztompka's (1999: 46-51; 2000; 2003; 2007) sociological theory of the *transfer of trust*. Thus, in this paper we develop an existing sociological theory, but transport it into a new field, namely organization and management theory. The application of Sztompka's work enables us to enhance our existing understanding of testimony and audit.

### **Trust, Institutions and Expert Systems**

The serious loss of trust in major institutions, expert systems and organizations is anticipated and reflected in the extant organization theory literature on trust (Bachmann & Inkpen, 2011; Kouzes & Posner, 2011: Ch.1; Kramer & Cook, 2004; Misztal, 1996: 3; Kramer & Pittinsky, 2012). Institution-based trust (Zucker, 1986) is distinct from more inter-personal and community-based forms of trust: "Institution-based trust means that one believes the

necessary impersonal structures are in place to enable one to act in anticipation of a successful future endeavour” (McKnight et al., 1998/2006: 119). Impersonal structures resonate closely with expert systems, such as auditing. It also extends to include legal regulations, professional codes of conduct, corporate reputation, employment contracts and others (Bachmann & Inkpen, 2011). In contrast to trust relying on personal interactions (Mayer et al, 1995; Hosmer, 1995: 398), expert systems are premised on systems trust (Giddens, 1990; Luhmann, 1979), which rely on a ‘leap of faith’ that the expert systems will perform as we expect them to (Nandkumar, 1999: 47; Möllering, 2001: 404). Specifically, we cannot *know for sure*, or *check comprehensively*, that all the audits that get done, are performed competently and with integrity – hence we need to have *faith* that they will. Following Giddens (1990: 34-5) and Sztompka (1999: 29-40), the converse of trust is risk: the potentiality of unexpected and adverse outcomes. If audit, as an expert system, is judged as too risky in its present format, then ‘too much trust’ is required to keep it going: “trust transforms uncertainty into risk ... Where there is no risk, trust cannot exist, nor is it needed.” (Bachmann, 2006: 395)

It is possible to distinguish four bases of trust: “One can trust individuals, organisations, institutions and systems.” (Noteboom, 2012: 9) Lane (1998: 14-19) distinguishes between micro-level, institutional, system and societal trust. Similarly, Banerjee et al. (2006: 305-6) identify three levels, but with cross-combinations, and this results in nine types of trust relationships, as trust may take place between entities at the same level (individual, organizational, societal), or between entities at different levels. Hence, they introduce the concept of the ‘pyramid of trust’ that spans different levels: I may trust a pianist because I know that she graduated from an esteemed piano school, was favourably reviewed in a newspaper, which I value highly, and the recordings are produced by a music company which I trust (and so on). The notion of *trust transfer* is related to this ‘pyramid of trust’ (Sztompka, 1999: 47). It is noteworthy that audit functions at all levels: from the inter-personal interactions between a client and auditor (Anderson-Gough et al., 2000), to the societal- or institutional-level trust that society places in auditors (Power, 1997) to ensure, for instance, the effective functioning of stock market trading. Whilst we can trust organizations, organizations themselves cannot trust “because it is *individuals* as members of organizations, rather than the organizations themselves, who trust.” (Zaheer et al., 1998: 141) Sztompka (1999: 46) concurs, arguing that “we ultimately trust human actions” – for example, if we trust the members of a parliamentary committee to be both competent, impartial and act with integrity, then we are more likely to trust the functioning of the system that the Committee was charged with investigating. In this sense, trust ‘travels’ or can be *transferred*. When trust

has broken down, ethical doubts may find their expression in critical questioning, directed at so-called 'bridge concepts', or problematic concepts, such as 'conflict of interests' or 'fairness' (Banerjee et al., 2006: 304). Thus, clients may critically interrogate professionals, or members of Committees may critically interrogate partners, who appear at the testimony to defend both the organization but also the profession.

Finally, organizational level trust in the *competence* and *integrity*, but not necessarily *benevolence*, of the Big Four is a necessary precondition for us to provide a restrictive oligopoly to a few select market operators. We conceive of audit as both an institution and an expert system: for the purposes of this paper, we will not distinguish therefore between system and institutional trust (Bachmann, 2006: 398) – indeed, we follow Barber (1983: 18) who argued that abstract systems are rooted in societal (legal, political, educational) institutions and, therefore trusting a system *means trusting the corresponding institution(s)*.

### **Trust in the Audit System before and since the Global Financial Crisis**

Audit is designed to ensure trust by providing “professionally structured and independent information to a variety of actors in the accountability process.” (White & Hollingsworth, 1999: 9) In the UK, “(w)hen the accounting process has been completed, an external audit evaluates and reports on the accuracy of the account. This is the second stage, and a separate stage, in the process to hold to account those responsible for the management of an organization’s finance.” (ibid. p.25) Building on this definition, we conceive of the expert system deployed by the Big Four firms as stretching across time, through the provision of judgements on the past (audit) and future (capital investment plans, tax planning, consulting), and stretching across space: both through the use of ‘immutable mobiles’ (e.g. numbers) (Briers & Chua, 2001), to translate dispersed organizational activities (e.g. multiple client locations) into a single entity (i.e. the audit report), and through the globalised presence of the Big Four across the world. However, we argue that during crucial performances at field-configuring events (McInerney, 2008), such as public inquiries, *person-based interactions can be decisive* for de-stabilizing or re-stabilizing institutionalised (systems of) trust.

The 2010 British House of Lords inquiry into the Big Four Audit Firms is but one such instance. The inquiry looked into the Big Four’s role in the Global Financial Crisis and assessed whether audit firms could be trusted with regard to their *competence* and their *integrity* – because audit quality typically refers to the *ability* of the auditor to detect misstatements and *willingness* to include this in the audit report (Eilifsen & Willekens, 2008: 3), in spite of the fact that the client is also their paymaster. One issue at stake was the question over whether

insufficient regulation played a major part in bringing about the financial crisis (Gamble, 2009: 7; Crouch, 2011: 163; Engelen et al., 2012). For neo-liberal free markets to work, the markets need to be able to trust the information produced by market participants (Casey, 2011; Stiglitz, 2010), such as the financial statements of companies (as ratified by auditors) and the ratings of debt (as ratified by credit rating agencies) (Rona-Tas & Hiss, 2010; Crotty, 2009; Goodhart, 2008; Campbell, 2010: 385; Holm & Zaman, 2012). A systemic financial crash intensifies scrutiny of such information-ratifying organizations. Auditors, some suggested, failed in their very duty to remain independent, place public interest above commercial interests and undertake their duties competently, objectively and prudently (Sikka, 2009).

The collapse in trust in many of the key actors of the international financial system resonates with a long standing scepticism within the accounting literature towards the conduct of the Big Four (Mitchell et al, 1998; McMillan, 2004; Fogarty et al., 2009), especially in the light of previous corporate failures – from Arthur Andersen, DeLorean Motor Cars, BCCI, Enron, Parmalat, to WorldCom (e.g. Aruñada, 2004). Germany experienced their own set of perceived audit failures, which affected the companies Balsam, Schneider, Holzmann, Flowtex, and Comroad, but, overall, “(t)he effect on trust in the audit profession and hence the audit itself ... is hard to determine.” (Köhler et al., 2008: 112, 136-7) While the recent banking crisis is on a vastly greater scale than previous crises and corporate failures, it reprises longstanding concerns about auditor independence, audit quality and conflicts of interest (Sikka, 2008; 2009). It is worth recalling that a decade ago Arthur Andersen’s association with the collapse of Enron was to undermine trust not only in Arthur Andersen, but in the expert systems employed by the Big Five (as they were then known) and the institution of audit more generally (Unerman & O’Dwyer, 2004). The legislative corollary of the Enron crisis was the passing of the Sarbanes-Oxley Act, which marked the biggest statutory intervention in the US capital markets and accounting profession since the 1930s (Fogarty et al, 2006); this illustrates that where institutionalised trust breaks down, new forms of regulation and state intervention may well have to follow (Bachmann, 2001/6: 462-3; Gillespie et. al., 2012). As such, “audit quality is not just a mere technical phenomenon, but is also part of the rhetoric employed by regulators, professional bodies and audit firms in the aftermath of corporate failures and resulting lack of trust in auditing.” (Holm & Zaman, 2012: 59) Thus, in the run-up to the Select Committee meetings there has clearly been a discursive contest surrounding audit, audit quality and the audit firms. Indeed, even before any testimony was given, the Select Committee was, reportedly, “unimpressed by the profession’s current performance.” (Chambers, 2011: 5)



Power (1997: 125) argues that assertions as to what audit is *not* (say insurance or certification) have “contributed to a loss of confidence in what is really being said by financial auditors.” Indeed, it is noteworthy that accounting irregularities are rarely uncovered by auditors, more often than not they are revealed by financial journalists or whistle-blowers. Yet, when irregularities are uncovered, it is almost always the auditors that find themselves in the spotlight. Shore and Wright (2000: 77) argued that “(a)udit encourages the displacement of a system based on autonomy and trust by one based on visibility and coercive accountability.” Shapiro (1987: 635) analysed auditors as an example of the *institutionalization of distrust*: auditors can be viewed as agents who control other agents, i.e. the management board, on behalf of principals (owners, shareholders). Both Power and Shapiro identify an ‘inflationary spiral’ (Shapiro, 1987: 652) where those appointed by us, because *we distrust*, in turn require *our trust*. It is systematic distrust in the accuracy of financial records produced by a company that leads to the perceived need for auditors, who in turn rely on our trust that *their* inspection of the company is accurate, reliable, objective, and conducted with integrity. Thus, “(t)he new accountability culture aims at ever more perfect administrative control of institutional and professional life.” (O’Neill, 2002: 46)

If, for Power (1994: 13; 1997: 123) and Sztompka (1999: 146), audit is a form of *latent distrust* and yet for its normal operation it is *predicated on trust*, we similarly suggest that forms of political governance following a breakdown in trust – such as the parliamentary inquiry we analyse – might remove our temporary distrust but *only insofar as we trust* in the effectiveness and integrity of the political system of inquiry, scrutiny, representation and reform itself.

A professional license to practice is, as with diplomas, accreditations, academic titles, and other such symbols of trust, an example of an “encapsulated credential” which allows us to “consider the target trustworthy without considering any other cues.” (Sztompka, 1999: 73) However, we know little about what happens when these symbols of trust are no longer fully functional. As Bachmann (2001/6: 463) points out, “it could be argued that the absence of strong forms of system trust at least results in greater awareness of the development of personal trust”. Building on Bachman’s point, we argue that at crucial junctures or ‘field configuring events’ (McInerney, 2008), trust is built up *at interactional level*: “‘Interactional trust’ rests on social actors’ reliability, integrity and communicative skills and does in principle not need powerful institutional arrangements to be developed effectively.” (Bachmann, 2006: 398) Indeed, in our case we aim to show that the political inquiry is an *institutionalised and*

*ritualised process of trust problematisation and (potentially) restoration based on interactional performances.*

A central focus for our theoretical contribution is Sztompka's (1999: 46-51) theory of *transfer of (dis)trust*: for example, widespread distrust in certain politicians may spread to the offices they occupy, it may extend to the government and eventually perhaps to the political regime as a whole – a *spiral of distrust* that we discussed earlier. Similarly, 'agencies of accountability' (ibid., p.47) including the parliamentary committee we examine, are potential pillars for the objects of our primary trust, in this case audit. There can be a *positive* cycle of transfer of trust (where political representatives sanction an institution as trustworthy); there can also be a *negative* cycle of transfer of distrust (where political representatives sanction an institution as untrustworthy and create further regulation and intervention aimed at restoring trust). In summary, we suggest viewing inquiries as *institutionalised rituals* (Meyer & Rowan, 1983; Brown, 2000) that attempt to scrutinise, interrogate, and ultimately *repair* trust by, in our case, providing renewed legitimacy to the institution of audit. This is the precise point where we adapt and develop existing sociological theory: we argue that inquiries are rituals pertaining to government and regulation, and consequently they constitute a very different type of repair mechanism compared to organization-level or corporate trust repair episodes covered in the extant trust literature (Dietz & Gillespie, 2012).

### **Audit, Markets and Socio-Political Settlements**

Why, then, are the State and associated regulatory bodies important for trust in the audit system? One of the central contributions of economic sociology lies in its explication of the socio-political embedding of markets (Polanyi, 1944/2001; Swedberg, 1997; Blyth, 2002; Mackenzie, 2009; Lounsbury & Hirsch, 2010). These insights allow us to understand how the audit market has been created by particular *national* political settlements: by this we mean that certain firms are permitted to operate within an oligopolistic market structure in exchange for their assurances of 'professional' conduct. This settlement means that professional service firms are entrusted with certain market privileges, such as restrictions on competition or absence of mandatory tendering, insofar as they are *trusted not to abuse these privileges* for self-interested commercial gain (Reed, 1996). Audit and the audit market are *reliant on a socio-political warrant and jurisdiction*, including privileges being granted to professions at national level (Humphrey et al. 2009). While the neo-liberal project, which is of a global nature (Harvey, 2006), proclaims that market relations can and should be freed, i.e. separated, from social and political relations (Friedman, 1962), in moments of crisis *the socio-*

*political sub-structure becomes the very resource of trust-restoration* (Polanyi, 1944/2001). The question for us in this paper is: to what extent can the political system restore our trust in the institutionalised system of audit? If it can do this, *how* does this take place?

Following Bachmann and Inkpen's (2011) argument, we argue that an *unconvincing* testimonial performance at the committee could undermine confidence and trust in the institution of audit (i.e. systems trust), as well as the Big Four (i.e. organizational trust); conversely, the ritualised display of a *tough* interrogation followed by *convincing* responses could result in a transfer of trust from a trusted institution, such as a parliamentary committee, to the Big Four. 'Transference' of trust means that the trustor draws on proof sources from which trust is transferred to a target (Doney et al., 1998: 606). Specific 'ritual' performances-as-interactions are thus crucially linked to the repair of potentially damaged trust at organizational and institutional (system) level. As Sztompka (1999: 46) argued, "(w)e ultimately trust human actions, and derivatively their effects, or products. Thus, in the case of systemic trust, we expect beneficial actions of ... the agents of various institutions and organizations, making up the fabric of our society." Sztompka's (2007) analysis of trust in 'science' is particularly relevant here, given the parallels with notions of 'professionalism': 'What we ultimately trust is the performance of these roles: competent, fair and honest, rational and critical, disinterested and innovative. Thus ultimately, in all these cases, 'trust in science' may be reduced to the trust in the actions of scholars, researchers, organizers of science, together making up the scientific community.' (ibid. p.213) We will now turn to an overview of the context of our study.

### *Background and Context*

Our study analyses the testimony of the Big Four in the UK as part of the House of Lords Economic Committee's investigation of the UK Audit market. The British Parliamentary System is bicameral, comprising of the House of Commons and the House of Lords. The former is an elected chamber, the latter is appointed with a small proportion of hereditary Lords also being members. Each house has a number of Select Committees that scrutinise important issues of the day (Ryle, 1997). The Select Committee System was introduced in 1979 following a 'fierce debate' (Hindmoor et al, 2009: 86) concerning the primacy of parliament: those advocating the Select Committee system argued that it was an important means of scrutinising government; the critics felt it was shifting discussion away from the parliamentary debating chamber and thus undermining parliament. As a result of the 1979 reforms, the 'power and scope of Committee inquiries were considerably strengthened and extended,

especially with regard to the provision of information, the attendance of witnesses and the production of records and papers' (Nixon, 1986: 416).

The House of Lords committees are, in contrast to those in the Commons, organized on broad 'topical lines' rather than scrutinising individual government departments; the corollary is that their inquiries are generally more broad-ranging than those in the House of Commons: "Lords Select Committees do not shadow the work of government departments. Their investigations look into specialist subjects, taking advantage of the Lords' expertise and greater amount of time (compared to MPs) available to them to examine issues".<sup>1</sup> The Economic Affairs Select Committee comprises of Lords with considerable financial expertise, with the Committee being composed of members drawn from the elite of the financial establishment who have a detailed understanding of economic affairs. Members have included former Treasury Ministers (Chancellor of the Exchequer, Chief Secretary to the Treasury), former Government Ministers, a former Deputy Chairman of JP Morgan, a Deputy Chair of the Competition Commission, and a senior financier and a well-known financial journalist.

Committees are commissioned to write reports into specific issues: 'They receive written submissions from interested groups or individuals, compel them if necessary to attend oral evidence hearings where committee members can interrogate them, and require relevant documents to be made available' (Hindmoor et al, 2009: 71) The oral evidence hearings are televised and these recordings (and transcriptions) are readily available to the public. Hearings on some issues are high profile affairs and conducted in an adversarial manner; the cross-examination of Rupert Murdoch and his son, James, in July 2011, during the phone hacking inquiry is a good example of this process.

Select Committees attempt, wherever possible, to produce reports unanimously agreed by members of the Select Committee, avoiding split reports along partisan lines. Government is obliged to respond to the report within three months of receipt; it is not, however, under any requirement to accept or evaluate the recommendations (Hindmoor et al, 2009: 72). While Select Committees have limited powers - they are unable to initiate, amend or reject legislation, nor can they insist that an issue is debated in parliament – they are held to serve an important function in Parliament (Hansard, 2001; Rodgers and Walters, 2006). Certainly, some former Government Ministers note (Mullin, 2009) that they seemed to exercise far more influence as a Chair of a Select Committee than as a junior minister. In an interview we conducted with a former MP, who had chaired a Commons Select Committee,

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<sup>1</sup> Source: <http://www.parliament.uk/about/how/committees/select/>

the interviewee stated that his committee work gave him ‘a fair bit of influence, certainly more than when a minister’<sup>2</sup>. The Lords Committees, according to our interviewee, were highly regarded because of their expertise and had more time to investigate issues.

The difficulty of assessing the concrete impact of Select Committees on policy is compounded by the fact that very few of the reports produced by the bodies are actively debated in Parliament, even less result in legislative changes. In spite of this, the widely accepted view is that Select Committees play a ‘valuable function within the political system’ (Hindmoor et al, 2009: 86), suggesting that influence within Parliament works perhaps more in way of ‘agenda setting’. It is almost certainly the case that this agenda-setting, consciousness-raising role is where Select Committees record their biggest impact – the *Culture and Media Select Committee’s* inquiry in 2011 and the subsequent *Leveson Inquiry* being a good example.

In outlining the rationale for the audit inquiry during a press conference, Lord McGregor explained the ‘problem’ with the audit market (‘dominated by a very small number of players’) and also framed the nature of the proposed ‘solution’ (‘promoting more competition’). The Big Four audit firms, he claimed, failed to pick up on ‘unsustainable risks’ being taken by the financial sector. The aim of the report emanating from the inquiry, he concludes, is to provide ‘better services to business and investors’. The committee invited evidence to be submitted to the committee by the 27<sup>th</sup> of September 2010 that related to the following questions:

- “How has auditing come to be dominated by four global firms? Should more competition be introduced? And if so how?
- Does a lack of competition lead to excessive fees being charged?
- Were auditors sufficiently sceptical when auditing banks in the run up to the financial crisis in 2008? Could they have done anything to mitigate the crisis? Can auditors now contribute to better regulation of banks?
- Do conflicts of interest arise between audit and consultancy roles? How can these be avoided or mitigated?
- Should the role of internal auditors be enhanced and how should they interact with external auditors?”<sup>3</sup>

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<sup>2</sup> Interview, August 21st, 2013, Edinburgh, Scotland.

<sup>3</sup> Twenty-one written submissions were also made to the inquiry, ranging from letters from private citizens, academics, Baker Tilly accounting firm, the California Public Employees Retirement System, International Audit and Assurance Standards Board, UK Shareholders Association and Corporate Value Associates. In total the Economics committee asked 553 questions, which were transcribed and made available on the House of Lords website. The sessions were also broadcast live on Parliament TV. On the

While our paper focuses exclusively on the hearing conducted on the 23<sup>rd</sup> November 2010, our knowledge of the other hearings and written submissions also informed our analysis and certain extracts from these other hearings will be cited selectively. The questioners and witnesses involved in the hearing we analyse are listed in Table 1. Prior to this meeting, a number of strong critiques of the Big Four had been made by other witnesses. While these are not the focus of our analysis here, this evidence is also available for interested readers<sup>4</sup>.

---- Insert Table 1 around here ----

Given the tight focus of our paper on a specific hearing, it needs to be acknowledged that our paper is limited in its knowledge claims, similar to other interpretive work. In Brown's (2000: 50) well-chosen words, "this paper is an artful product designed not just to inform but to persuade ..." – indeed, and this means that we cannot engage in debates over how *representative* the chosen day of testimony or extracts are. Our knowledge claim is based on theoretical and internal validity *not* generalizability.

### **Research analytics**

Our analysis is underpinned by the principle that legitimising accounts play a crucial role in the micro-institutional work that underpins the continued legitimacy (or otherwise) of a field, which underpins the trust that social actors place in institutions (Vaara & Monin, 2010; Holm & Zaman, 2012). For example, an appeal to professional values, such as truth or integrity, can serve to establish trust that a particular actor or organization will serve the interests of a client or wider society above more narrow self-interests (Suddaby & Greenwood, 2005). Similarly, accounts can also serve to de-legitimise and de-institutionalise previously accepted practices by undermining the trust that we place in them (Vaara & Tienari, 2008; Maguire & Phillips, 2008; Maguire & Hardy, 2009; Hardy et al. 1998). More specifically, we draw on McNerney's (2008) approach to studying the role of accounts in *problematizing*, or *justifying*, the arrangements prevailing in an established institutional field. Our approach can best be described as *abductive*: we build on existing theory (deduction), but at the same time we are

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30<sup>th</sup> of March the Economics Affairs Committee published their report. See: <http://www.parliament.uk/business/committees/committees-a-z/lords-select/economic-affairs-committee/inquiries/auditors-market-concentration-and-their-role/>

<sup>4</sup> <http://www.parliament.uk/business/committees/committees-a-z/lords-select/economic-affairs-committee/inquiries/auditors-market-concentration-and-their-role/>

strongly guided by the data (induction). Thus, during the period of data analysis and writing a first draft, there is a “constantly going ‘back and forth’ from one type of research activity to another and between empirical observations and theory” (Dubois & Gadde, 2002: 555).

The analysis was conducted as follows. Each of the three authors independently read the publicly available transcript of the testimony given by the senior UK partners of the Big Four on the 23<sup>rd</sup> November 2010, noting in particular the way in which trust in the expert system of audit was problematized or repaired by the questioners (Lords) and respondents (Big Four). In addition to this, as part of the revision of this paper an interview was conducted with a former MP, who had served as a Chair of a Select Committee.

### **Trust Problematisation**

Deductively speaking, i.e. in light of what the literature says, given the multi-faceted nature of trust (Mayer et al., 1995/2006: Table 1), it is important to distinguish between the trustor’s belief in the respective competence, benevolence and integrity of another party (Gillespie et. al., 2012; Mayer, et. al., 1995/2006). Inductively speaking, our analysis shows that trust was problematized by the Committee members along two dimensions, namely *integrity* and *competence*. Thus, in way of performing *abduction*, we propose that benevolence did not form part of the trust problematisation process, indicating that auditors need to be perceived as competent and not (excessively) self-interested or dishonest, but not necessarily ‘kind-hearted’ or ‘charitable’, in order to be trusted (Neu, 1991: 296).

#### *Integrity*

Relationships of exchange place the trustee in a position of vulnerability, where the potential for self-interested exploitation is possible (Frowe, 2005: 43). Integrity relates to perceptions that a party (individual or collective) will not exploit the other party in pursuit of self-interest. Two integrity issues were problematized by the Lords in their questioning of the Big Four, namely *competition* and *conflicts of interest*. The Big Four were firstly charged with anti-competitive, protectionist behaviour designed to maintain or extend their oligopolistic position: “nearly almost all the audits in the FTSE 100 are now carried out by the Big Four and most of them in the FTSE 250.” (Chairman of Select Committee on Economic Affairs, Lord MacGregor) This questioner also raised the issue about the potential impact of one firm withdrawing, “since you are only four, any threat to withdraw could be said to be an abuse of a statutorily privileged position?” Indeed, if “the switching rates for a FTSE 100 company are every 48 years; for a FTSE 250, every 36 years and for all listed companies, every 25 years.

How can you possibly argue with a 4% churn every year that that's a competitive market?" (Lord Forsyth)

Secondly, the Big Four were also questioned about potential conflicts of interest relating to consultancy and advice services to clients they also audited: "Is there not a conflict of interest though at the heart of this because you're providing advisory services, let us say, on taxation and tax planning, which is a major part of the professional services you supply, and then another group from your firm come along and audit the same thing?" (Lord Hollick) The charge here was that the Big Four exploited their position of power as an oligopoly and placed their self-interest in profit above their duty to investors and the wider public – thus undermining the trust that society places in auditors to produce fair, accurate and honest assessments of the financial state of audited companies.

---- Insert Table 2 around here ----

Table 2 summarizes the four main points raised by the questioners, which problematized the trustworthiness of the Big Four with regard to *integrity*. We focus on these points because they potentially serve to undermine the credibility of the Big Four's accounts and, thereby, pose questions around the trust in the expert system of audit. A detailed analysis of 'trust problematization' strategies with regard to *competence* is outlined in the next section.

### *Competence*

Competence relates to perceptions that a party (individual or collective) has the required skills, knowledge and experience to deliver on a promise or fulfil a task (Barber, 1983: 14). Thus, a trustor could have high levels of trust in the integrity and benevolence of the trustee, but because of their belief that the trustee cannot competently execute their side of the bargain, would not enter into a relationship. For example, the trust required to feel confident about air travel relies not only on trusting the integrity (and much less benevolence) of the pilots, air traffic controllers and aeroplane manufacturer and maintenance crew, but most importantly on trusting their competence derived from qualifications, training and experience (Gillespie et. al., 2012; Frowe, 2005: 35-37; Sztompka, 1999: 52).

Competence-based trust was problematized by the Lords in their interrogation of the Big Four with regard to two issues, namely *practices of information exchange/representation* and *auditing standards*. The Big Four were charged with failing to communicate important



information with investors and failing to have proper dialogue with regulators, in particular around risky financial products they audited in the banks. Specifically, Lord Lawson questioned why the auditors “didn’t say anything to the regulators at that time”, when concerns about risk and leverage within banks were first coming to light. Questions were also raised about alleged failings to maintain proper prudence in their audit judgements of the banks in particular: “do you think IFRS accounting standards led bank auditors to a tick-box approach instead of scepticism and prudent judgement on client banks as going concerns?” (Lord Forsyth)

---- Insert Table 3 around here ----

Table 3 summarizes the allegations with regard to five problematic practices raised by the questioners, which problematized the trustworthiness of the Big Four with regard to their espoused competence.

Thus, in summary, the problematisations voiced by the Lords serve to combine the two core elements of competence and integrity: either the auditors failed to uncover or understand the financial risks being taken by the banks (e.g. high leverage, risky trading practices, poorly risk tested financial models) – a failure of *competence*; or the auditors did see the financial risks being taken by the banks and deliberately chose not to inform investors or regulators to protect their commercial interest in maintaining their client relationship – a failure of *integrity*. A detailed analysis of trust repair strategies is outlined in the next section.

### **Trust Repair**

The representatives of the Big Four used a variety of trust repair strategies. In terms of questions of *integrity*, our analysis has identified three main strategies used to attempt to repair trust - cosmological, higher values and legal compliance – which we will address in turn. First, the Big Four claim that the state of market concentration and low switching rates are the result of two natural forces and universal ‘*cosmological*’ laws: market forces and the forces of globalisation. Cosmological statements present the current state of affairs as the result of *natural forces* and *universal laws* (Suddaby & Greenwood, 2005). Representatives of the Big Four claimed that “the degree of concentration in the audit market has arisen as a direct result of market forces” (John Connolly, Deloitte), that it “...is the natural order of events in our industry” (John Griffith-Jones, KPMG) and “...the result of market choice” (Ian Powell, PwC),

also taking into account “the natural tendencies to globalisation...” (John Griffith-Jones, KPMG). By so doing, the Big Four attempt to restore trust by assuring the Committee, and the wider political system and general public, that the oligopoly is a result of client choice and their superior service, as opposed to self-interested protectionist behaviour aimed at restricting competition. Second, they (not surprisingly) appeal to higher values to present themselves as ‘above the fray’, as ‘above’ narrow self-interest, because of their professional commitment to ‘audit quality’: “So to be able to service clients that are very complex, that cover so many different territories, with real quality—and that is the ultimate focus of everything that we do, the quality of the audit...” (Ian Powell, PwC). This appeal to higher values – such as truth, knowledge, justice, society, public good, and so on – is a common feature of the discourse of professions (Freidson, 2001). Third and finally, the Big Four dismissed the notion that a conflict of interest does indeed exist between their auditing and consultancy services (such as tax planning advice) by stating that they ensure *compliance* with existing regulations: “... there are explicit rules already in existence that fundamentally say that you cannot audit your own work and there’s then a whole range of very specific exclusions ... as a matter of fact, ... in the last 12 months, no FTSE 100 company paid anything to their auditors for management consulting services.” (Mr John Connolly, Deloitte) Thus, existing regulation is presented as sufficient to ensure that the audit industry can be trusted, without the need for *additional* intervention or regulation.

---- Insert Table 4 around here ----

A more complex array of trust repair strategies was used to respond to the problematization of their *competence*. In addition to appeals to cosmological forces and higher values, the Big Four also made reference to institutionalised conventions and jurisdiction, and they utilized pledges and concessions. First, *cosmological* statements were employed to justify the use of arguably more ‘light touch’ or ‘tick box’ IFRS standards, which replaced the more prudent and sceptical UK GAAP standards. The change was attributed to changes in the business environment, such as the introduction of new financial products like derivatives. This presents the IFRS standards as a natural and perhaps inevitable evolution rather than, say, a *self-interested* or *complicit* move to ‘lighter touch’ audit standards. Second, *higher values* of ‘protecting the public interest’ were used to justify their (lack of) communication with shareholders. The Big Four justified their actions on the basis of needing

to avoid giving market advantage to a select group of shareholders, thereby undermining their duty to act fairly and not privilege certain investors, along with practical considerations of how to secure meetings with inactive shareholders (see Fogarty et al., 2009). Thus, while a lack of communication and information exchange is recognised by the Big Four, this is not seen to represent a fundamental breakdown in trust because it is a result of external factors outside their control, *not a deliberate strategy* of avoidance or dereliction of duty.

Third, lack of regular communication and information exchange with shareholders and regulators was attributed to *institutionalised conventions* – the way things have always been done. This accounted for their actions in ways that mitigates the implications that such practices were a sign of *incompetence* (i.e. they failed to notice financial irregularities or high-risk investments) or lack of *integrity* (i.e. they did notice but sought to place commercial self-interests above public interest). Fourth, the problematisation of trust in their auditing of the banks in particular was handled through appeals to professional *jurisdiction*: what the job of the auditor *is*, versus what is *outside* their scope, such as assessing the viability and risk of the business model used by a firm. Fifth and finally, *concessions* and *pledges* were used to show that (a) they accept that some kind of transgression in trust had taken place, (b) accept some (albeit limited) responsibility for their part therein, and (c) offer some attempt to heal the relationship through promises regarding future conduct: three important features of verbal accounts designed to repair trust (Lewicki & Polin, 2012). For example, Scott Halliday from Ernst & Young conceded that more needed to be done to improve dialogue, and pledged to improve practices in future: “If you look at the banking crisis, all four of us had meetings with the Bank of England around trying to improve the dialogue between the Bank of England and the firms. I think there’s more that can be done in that area including ... more of a dialogue going both ways with auditor and the regulators.” Concessions were also made that the standards of audit had slipped and traditional prudence of judgement had been lost, and pledges to improve communication and information exchange with regulators and shareholders were made.

---- Insert Table 5 around here ----

In summary, the representatives of the Big Four used a variety of trust repair strategies. They are illustrated by typical quotes in preceding Tables 4 and 5. We shall now discuss the ‘official report’ and efforts undertaken towards structural reform.

## The Official Report and Structural Reform

Our analysis above focuses on the problematization of trust by the Lords in their interrogation of the Big Four. Testimonies given to the other hearings within the Inquiry - regulators, professional bodies, academics - yielded considerable disagreement about whether trust *had*, in fact, broken down due to a failure in integrity and competence. Some witnesses – notably the academic witnesses – provided a critical analysis of regulations (“What we lost in that process of moving to IFRS for UK-listed companies was the true and fair view, the prudence principle and the principle of substance over form”, Prof Beattie) and market structure (“it is not a market at all, in the sense that there are not willing buyers in which one ordinarily thinks of markets. There are enforced buyers by statute ...”, Prof Power) which displaced a focus on individual firms in favour of broader regulatory issues. Others, the professional bodies for instance, vehemently denied that any breach or breakdown in trust (especially with regard to the competence dimension) had occurred: “we believe that audit itself is fit for purpose in terms of the review of financial statements”, (Tilley, CIMA); “there is plenty of evidence that we can bring forward to say that the audit market delivering good outcomes happens but that is not grounds for being complacent” (Hodgkinson, ICAEW). Representatives from smaller consultancy firms similarly defended the status quo: “So what we have now is a system that works quite well. It suits the audit firms, it suits the management and it usually gets the right answer...” (Hayward, ‘Independent Audit’). In contrast, representatives of the medium-sized audit firms (Mazars, Grant Thornton, BDO, and RSM Tenon) warned that “in the event that one of the Big Four were to exit the market, there is a risk of systemic failure in the market” (Michaels, BDO). Because 70 % of FTSE 100 companies have not had an audit tender for 15 years, “it is currently a very stagnant market ... no matter which capability you have, you just don’t have the opportunity of showcasing it” (Herbinet, Mazars). Similarly, the Chairman of the *Office of Fair Trading* acknowledged that “...competition in the market for audit services to large companies may be limited, as a result of barriers to entry and expansion, switching costs and limiting choice in firms” (Collins). During the session for the Representatives of FTSE 250 firms, it was pointed out that “...the apparent falling away of the dialogue between the audit firms and the regulator” (Roberts, Finance Director, British Land) has been a negative development. By drawing on a fairly comprehensive range of witnesses with varying claims to credibility, whether based on academic expertise, practical experience or senior position, the inquiry aimed to strengthen the authority of the process that would lead to the final report; and thus, by implication,

increase the likelihood that the text, i.e. the final report, will “be received as authoritative.” (Brown, 2004: 96) What counts is not what the various parties claim in their accounts, but rather what version gets constructed in the final official report produced by the Lords, and indeed what changes followed this report. Following Brown (2004: 96), “inquiry reports are particularly interesting attempts to present a univocal and coherent view on what are generally readily acknowledged in the reports themselves to be complex and uncertain events.” Whilst the process of construction is necessarily contested, multi-vocal and fragmented, the outcome is presented as univocal, broadly uncontested and cogent. A singular voice of one author, even where a plurality of authors were in fact at work, is a necessary fiction for inquiry reports.

The official report concluded that auditing is an oligopoly, thus it lacks adequate competition and protection against the self-interested behaviour of the Big Four; furthermore, the Big Four failed in their duty to protect the interests of the investment community and wider public at large, and recommended that a range of interventions were necessary in order to restore trust. Of course, the participants themselves knew full well that issues of trust and legitimacy were at stake in such a public inquiry process – as demonstrated by *The Association of Chartered Certified Accountants’* (ACCA) extensive letter to the *Auditing Practice Board*<sup>5</sup>. While it is clear that the Inquiry process itself represented an attempt to transfer trust from the political system to the audit industry, through the highly ritualised and ceremonial display of ‘accountability’ (Power, 1997; Shore & Wright, 2000: 83-84; also Miller & Rose, 2008: 212), trust had not been fully restored through this process alone. Indeed, the continued presence of dis-trust is evidenced in the repeated calls for greater regulation, improvements in auditing standards and, above all, the referral of the audit industry to the Competition Commission for investigation<sup>6</sup>. The Competition Commission delivered a provisional report in the summer of 2013<sup>7</sup>; the report is noteworthy as it is critical of the audit market as currently configured. The Commission made a number of recommendations that can be read as trying to repair trust in the expert system of audit: (i) FTSE350 firms should put their audit out to tender at least every five years; (ii) Financial Reporting Council should audit each audit engagement at least every five years; (iii) Prohibition of Big Four clauses in loan

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<sup>5</sup> <http://www.frc.org.uk/Our-Work/Publications/APB/Consultation-on-audit-firms-providing-non-audit-se/Responses-to-Consultation-on-audit-firms-providing/ACCA.aspx>

<sup>6</sup> “Big Four Audit Tenders benefit from ‘virtuous circle’”, *Accountancy Age*, 01/10/2012. <http://www.accountancyage.com/aa/news/2213523/big-four-audit-tenders-benefit-from-virtuous-circle>.

<sup>7</sup> <http://www.competition-commission.org.uk/media-centre/latest-news/2013/jul/cc-outlines-measures-for-audit-market>

agreements that compels a company to use one of the Big Four; (iv) strengthening the power of the audit committee in firms.

These recommendations evince a certain level of distrust in the audit market. The measures suggested are very much directed at repairing trust in the current audit market; they stop short of a more fundamental shake-up or break-up, such as a move to replace the Big Four with a state-run institution. However, a break-up may also be initiated by the European Commission under competition rules<sup>8</sup>. In 2012, the European Commission released a briefing document suggesting that audit firms should be restricted to the provision of 'audit only' in the EU, that audit firms should not sell other services to clients, and that there should be mandatory rotation of auditors every six years. The European proposals extend far beyond those of the UK Competition Commission. One conclusion is that commercial interests were not viewed as fundamentally incompatible with trust in the audit expert system. It was not seen as a case of whether commercial firms can be trusted to be objective, fair and prudent in auditing, but rather what forms of oversight and regulation are necessary to ensure that they maintain these standards and do not exploit their oligopolistic privileges.

## Discussion

In this paper we argue that inquiries, commissions and committees "render the actions and judgments of professionals governable in new ways" (Miller and Rose, 2008: 109), and are a means of governing organizations and enforcing accountability. It is a feature and is forming a part within a broader picture of *distributed public governance* in the U.K. (Flinders, 2004). A failure to maintain trust in the expert system of audit could lead to new forms of state intervention in the field (Fligstein & McAdam, 2012: 76), such as a prohibition of certain activities (such as consulting services), an enforced break-up of the oligopoly, or enforced joint audit, following the example of countries like France. We argue that whether such outcomes are seriously considered or not arises from *the performative effects* of the interrogative rituals of the inquiry. For example, the Lords constantly questioned the premise of the Big Four's standard operating practices, frequently expressing their incredulity at some of the established practices. At a minimum, an inquiry might simply amount to an institutionalised *ritualised display of holding-someone-to-account* that signals to society that something is being done even if, actually, actions are modest and fairly ineffectual (Meyer & Rowan, 1983;

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<sup>8</sup> "Michel Barnier moves forward to break up Big Four Audit Firms", Daily Telegraph, 29 November 2011. <http://www.telegraph.co.uk/finance/newsbysector/supportservices/8924093/Michel-Barnier-moves-forward-to-break-up-Big-Four-audit-firms.html>

Brown, 2005). By taking this argument a step further, some have argued that public inquiries are therefore little more than a 'smokescreen', a *veneer of accountability* enabling the established power relations and lines of influence between business and politics to remain unchanged (Engelen, et al., 2012; Froud et al., 2012). Our own analysis differs from this view in that we propose to connect Miller and Rose's theory of governmentality with Sztompka's (1999: 46-51) theory of transfer of (dis)trust: we argue that 'agencies of accountability' which exemplify institutionalized trust (ibid. p.46), such as the Lord's Economic Affairs Select Committee in our case, could help replenish the diminished trust experienced by the Big Four.

Following Gillespie et al's (2012: 191) typology, comprising (a) apology, (b) denial, (c) excuse/justification and (d) reticence, the trust repair tactics of the Big Four can be classified as a combination of 'denial' and 'excuse/justification'. Gillespie et al. (2012: 191) claim that denials are typically effective where the violator is innocent, but that denials are ineffective where the violator is guilty of the trust violation. Our study takes the perspective that we can only view these matters through a *veil of ignorance*, which means that we can only study the role of denials and excuses/justifications in the interactional process through which 'guilt' or 'innocence' is discursively established in the course of an investigation. In our study, the deployment of denial and excuses/justifications seemed largely *ineffective* at shaping the official version of what is wrong with the audit industry and whether they are to be trusted to continue 'business as usual'. We propose that it is not the use of denial or justification/excuses *per se*, but rather how plausible and convincing they discursively appear to powerful institutional actors, such as political representatives, members of a public inquiry or regulators, that shape whether or not a violator is deemed guilty of a breach of trust. A key insight from our paper is that it is important for trust research to focus on the role of accounts in field-configuring events such as public inquiries (McInerney, 2008; Kramer, 2012; Gillespie et al., 2012) in ways that *bridge* the study of *situated* accounts at the *micro* level, and *systems* of institutional reform at the *meso* and *macro* level. In our case, the Big Four's attempts to repair trust were largely unsuccessful; consequently, a package of measures aimed at reform has been recommended in order to restore trust in the expert system of audit.

In addition, an important nuance also emerges from our study: we suggest that explicit recognition of violation or transgression, coupled with direct apologies and expressions of regret, guilt or blame, do not serve to restore trust in expert systems, but instead further undermine trust. For instance, admission of a failure in duty and lack of objectivity due to commercial interests would not only have opened the Big Four to potential litigation or criminal prosecution, but would have also intensified the dis-trust of the expert

system of audit. In the case of expert systems, therefore, we argue that trust ‘violators’ have to strike a balance between showing humility and/or regret, accompanied perhaps by pledges of future trustworthiness, without directly admitting fault, liability and blame. If auditors admitted failings in uncovering fraud or risk (competence) or failings in reporting them to investors or regulators for fear of damaging their client relationship (integrity), the entire audit expert system would have been at risk of a more severe breakdown in trust. In our case, strategies of appeal to higher professional values, legal compliance and cosmological forces (such as market forces, globalisation, and adaptation) played an important role in providing that balance.

This point connects to one of the findings from our study, namely the predominance of repair strategies (namely cosmology, higher values, institutionalised conventions and jurisdiction), which *do not accept that a violation or transgression of trust has taken place*. Other, perhaps less frequent, repair strategies - concessions and pledges - are distinct in that they recognise a transgression of some kind, such that it warrants some kind of acknowledgement of the breach in trust, admission of responsibility, and attempt to compensate, reassure or otherwise heal the relationship. This suggests that our study stands in contrast to other studies which show the importance of acknowledgements of transgression, admissions of responsibility, offer of penance, repentance or repair, requests for forgiveness and expression of remorse and contrition in trust repair (for example, Lewicki & Polin, 2012). Apologies and admissions of responsibility were notably absent from the Big Four in our study.

Our study has shown that it was only after a ritualistic display of ‘scrutiny’ and ‘accountability’ through the thorough interrogation of accounts that trust repair through structural reform became possible. We propose that structural reform is crucially dependent on the production, interrogation and interpretation of (often competing) accounts to establish an ‘official’ and ‘authoritative’ version of what (if anything) *is wrong* and what (if anything) *can be done* to restore trust. Our study has shown that the testimonial accounts produced by the Big Four were largely discredited, disregarded or dismissed in the official report produced by the Committee (and the governmental response thereafter), who instead concluded that the audit market in its current form could *not* be trusted and structural reform *was* to be recommended. One might argue that by showing a critical approach with a willingness to challenge powerful industry incumbents, the report authors enhance their own credibility and, thus, the authority of the final report.



## Conclusion

Audit has expanded into ever more regions of public and private life and pervaded our very way of thinking and reasoning about ourselves and those with whom we interact (Power, 1997; Strathern, 2000). Audit is premised on a systematic *distrust* of companies, viewed as having a potential interest in manipulating their financial records; being able to trust companies is the hoped-for outcome of the audit system. Checking and certifying these financial records is one of the very ‘trust-regulation mechanisms’ that are designed to (re)assure trust in the financial system; for this assurance to operate effectively, the expertise and independence of auditors must itself be trusted. In short, an effective audit should produce trust and comfort for stakeholders relying on the verisimilitude of the company records. Auditors can, however, only be trusted *if they are believed* to have (a) a certain body of expert knowledge that ensures their competence, (b) a commitment to higher professional values that ensure they themselves are not solely driven by self-interest, and (c) to be themselves “certified by a trusted agency.” (Zucker, 1986: 606) That the audit industry is the subject of a political inquiry - in effect being ‘audited’ - is a manifestation of the widespread breakdown of this belief in the aftermath of the financial crisis (Gillespie et. al., 2012; Engelen, et al 2012; Davies, 2010). Our study has shown that the question of trust in both the competence and integrity of the audit industry in the UK has been played out in the course of a parliamentary inquiry led by the *House of Lords Select Committee on Economic Affairs*.

Extant trust research primarily focuses on two distinct levels: the micro-level of trust within dyadic inter-personal relationships, cognitive processes and verbal accounts, and the macro-level of system-level and institutional trust (Gillespie et. al., 2012). Building on this work, we show how trust ‘travels’ (Currall & Inkpen, 2006: 236), across and between levels. Our study demonstrates that it was only through the situated accounts produced by a range of institutional actors at the hearings that the structural reforms recommended by the Inquiry could plausibly be put forward. Only by establishing what went wrong, and who or what was responsible, was the committee able to produce legitimate recommendations on structural reform. Building on Janoff-Bulman & Parker’s (2012) argument, we argue that trust can only be transferred from the political system to the audit expert system if political representatives are seen to be non-partisan, thus free of allegiance to commercial interests or specific outcomes. Our study therefore shows how the two dimensions – the micro-level of situated accounts, and the meso- and macro-level of legal, political and regulatory systems – are linked.

More specifically, we illustrate how the re-establishment of trust operated through three stages: (a) public displays of trust problematisation (see Tables 2 and 3), (b) the

production of an official report providing an ‘authoritative’ and ‘objective’ view of the trustworthiness of the industry and profession, promulgating an official evaluation of the trust repair strategies employed by the ‘violators’ (see Tables 4 and 5), and (c) the translation of this document into legislative and regulatory changes.<sup>9</sup> Before trust restoration mechanisms can be put in place, inquiries have to ensure that, (a) a violation of trust has actually occurred, (b) the violators are identified, and (c) the violators are interrogated with adequate scepticism to establish what went wrong. The four strategies we have identified, which sought to problematize both the integrity and competence of the Big Four through interrogation of the industry’s competition, conflicts of interest, practices of information exchange and representation, and auditing standards (see Tables 2 and 3), contribute towards theorising how trust problematisation takes place in the setting of a public inquiry. As we discussed earlier in this paper, the limitation of our approach is that our paper needs to be assessed in way of its plausibility and theoretical validity, rather than with regard to the concept of external validity (or generalizability), as it is far from straightforward to demonstrate how this inquiry, or this hearing within the inquiry, are typical or representative of developments more broadly.

In addition, our findings help us understand some of the distinctive features of the maintenance of trust in professions, such as audit. In other industries, anti-competitive behaviour and selling on additional services may be similarly illegitimate according to socially defined norms of ‘fair play’ and ‘objectivity’ but, crucially, would not result in a fundamental breakdown of trust in the organizations themselves. Undertaken by a retail firm, say, such behaviour would not be socially sanctioned, but would also not unilaterally undermine consumer confidence in the firm’s products or services. Nor would it be likely to spark a parliamentary inquiry. Should trust in the competence of auditors to produce an accurate and prudent assessment of the financial health of a company be undermined, on the other hand, investment decisions and markets run the risk of de-stabilisation. Indeed, to be seen as merely ‘rubber stamping’ - having their judgement coloured by their self-interested need to maintain the client relationship (Turley, 2008: 213) or avoid litigation – might well fundamentally undermine trust in the judgement of the auditors.

Finally, our study suggests that trust research can be advanced by studying the processes through which specific behaviours, actions or events become associated with trust (Elsbach, 2004; Roberts, 2001; Powell, 1996), thus contributing to “a better understanding of

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<sup>9</sup> We have drawn up tables summarising these developments. These have not been included due to space constraints but we are happy to make them available upon request.

the antecedents and consequences of trust in contemporary organizational contexts” (Kramer & Cook, 2004: 2-3). In many cases, behaviours are unambiguously associated with a breach of trust, such as fraud in the case of financial relationships. Yet, as studies of trust across generations (Davis et. al., 2012) and across nations (Bohnet, et. al., 2012) have shown, there exists considerable diversity in different individual and collective perceptions of what is deemed ‘untrustworthy behaviour’ and what would count as betrayal (Robinson et al., 2004). The decision to create a cross-partisan political inquiry into auditors in the UK, but not in other European countries or indeed in the U.S., also highlights this point. We will discuss the issue of national differences in more detail in the next section.

Our study also contributes another dimension, namely the way in which external events play an important role in transforming previously accepted behaviour. In the case of the audit industry, the range of behaviours problematized by the Inquiry – including low switching rates, oligopolistic domination by four major players, infrequent meetings with shareholders and regulators, and use of IFRS standards – has long been in place without being seen as an indication that auditors were less than trustworthy. Indeed, Chandler & Edwards (1996) have shown that auditor independence, competition between auditors, and audit regulation were discussed as early as 1896 as potentially problematic issues. The financial crisis clearly acted as a decisive event which shifted perception amongst key institutional actors including the government and the regulators, framing the current state of affairs as inadequate. Our study therefore has strong resonance with the wider critique of professions as ‘cartels’ who use idealized versions of themselves as masters of a unique codified body of knowledge, who adhere to higher professional values or ideals (truth, justice, public good) as a façade to hide the monopolistic protection of commercial interests (Reed, 1996; Freidson, 2001). Our study contributes to how such problematisations are accomplished *in situ*, *by whom*, and *to what effect* in relation to the potential repair of trust. Our conclusion is therefore not that auditors *have* breached trust in their integrity and competence through protectionist, self-interested behaviour, but rather that what matters most is whether in the *opinion of authoritative institutions* (such as parliamentary bodies) they have broken the trust that society vests in them.

### **Wider Theoretical Implications**

What are the wider implications of our analysis for theory development in terms of studies of expert systems, trust, and accountability? The point of departure for this paper is that while “the auditing profession has a vested interest in convincing users that accountants

can be trusted” (Holm & Zaman, 2012: 59), the Inquiry is evidence that this trust has been problematized. Thus, “the institutional environment which determines the quality of interactions between firms” (Bachmann, 2001/6: 452) has become problematic in its ability “to generate shared economic, technical, cultural and social knowledge and to produce collectively accepted norms of business behaviour.” (ibid) What had been the basis of normality for the institution of Audit to function has now become the basis for asking: can we still afford our *normal trusting attitude* vis-à-vis audit? Major crises and scandals are interesting precisely because they typically lead to a *shift in sensemaking* about what is (or should) be accepted practice in a particular industry (Maitlis & Sonenshein, 2010). Our study contributes to the body of work that seeks to understand the role of trust problematisation and repair during major crises, failures and scandals by enabling us to learn lessons from such “negative deviants” (Kramer, 2012: 70), i.e. a major “public trust crisis” (Eilifsen & Willekens, 2008: 1). The challenge for future research into policy-making is to learn how to ensure effective vigilance and scrutiny of expert systems *before* such major crises or scandals occur.

A number of literatures shed light on our understanding of national differences regarding the institutionalisation (or lack thereof) of trust relationships: Doney et al. (1998: 601) provide a more general conceptualization regarding “the ways national culture impacts the trust-building process.” From a socio-economics perspective, Harriss (2008), found a high degree of ‘selective trust’ in India, referring to trust “amongst groups of people within specific social networks” (ibid. p.320), arising when institutionalised sanctions and incentives are weak and law enforcement is poor. Child and Möllering (2003: 69) showed that in China “economic relations are strongly dependent on trust ...”. Trust in the German business environment is also judged to be high, but for very different reasons: industrial banking, with long-term loan arrangements between banks and companies are the institutional basis for “lasting and nurturing relationships of trust ...” (Misztal, 1996: 215). The Varieties of Capitalism (VoC) literature has drawn comparisons between different national business environments and made the contrast between Coordinated Market Economies (CMEs), such as Germany, with Liberal Market Economies (LMEs), such as the UK and USA, (eg Hall & Soskice, 2001; Hall & Gingerich, 2009), but so far little is known about arrangements of auditor regulation and corporate governance (save for Vitols et al., 2001). Some have argued that supervisory board representation enjoyed by banks and insurance companies provides them with some insights into the internal financial affairs of the company in question and therefore makes them less dependent on the information provided by auditors (Köhler et al., 2008: 136). This structural position means that the German National Business System, for instance, is overall far less

dependent on the checking functions of auditors which could be seen as a market solution appropriate in the '*shareholder model of capitalism*' – perhaps, not surprisingly, there has been no equivalent parliamentary inquiry into auditor effectiveness in *stakeholder capitalist Germany*.

One question worth exploring in future research therefore is whether CMEs are less dependent on external auditors than LMEs. Based on our analysis, we suggest that "legal norms and trust are more than compatible. In fact, legal regulation can foster the constitution of trust" (Bachmann, 2001/6: 451). According to Sitkin and Roth (1993/2006: 298), existing literature "suggests that attempts to 'remedy' trust violations legalistically frequently fail because they paradoxically reduce the level of trust rather than reproducing trust." Following Bachmann and Inkpen (2011), "(e)xtensive empirical research is needed to show whether our conceptual framework helps to fully understand why and how institutions matter, where institutional-trust can stand in for interaction-based trust and vice versa." We have addressed Bachmann and Inkpen's (2011) call for research by showing how, during phases of problematisation and restoration, *institution-based trust is dependent on the ritualised interrogation of accounts and production of official accounts*.

To our mind, audit's 'epistemic obscurity' – to borrow a phrase from Power (1999) - is due to audit requiring *both system and personal* trust. This is reflected in the interactional dynamics at the testimony: when the partners are pushed to 'account for' why they have not reached a different assessment in their previous audits (for example, with regard to banks that subsequently failed and required state bail-outs), their answers make clear that for audit to function, *both system and personal trust needs to apply*. Audit opinions are largely rule-bound, but within a 'grey zone' they are also judgments that involve discretion and therefore cannot be fully accounted for with reference to a rule system. This is what Power (1997: 28) refers to as audit's 'weak knowledge base': "there is no way of specifying the assurance production function independently of a practitioner's own qualitative opinion process". In this sense, audit is, like banking, a *trust-intensive industry* (Swedberg, 2010: 71). This is indeed a central point: audit is a *judgment*, which in itself can only partially be accounted for and, therefore, *the way it was reached procedurally needs to be trusted*. As Power (1997) argued "the epistemic foundation of financial auditing, i.e. the relation between its inputs and the production of assurance, is essentially obscure. Ultimately, financial auditing requires that the judgements of auditing experts are trusted." (ibid. 15) We therefore conclude that auditors are an expression *both of our trust and our distrust*. Hence, rival accounts to the Big Four's account of 'sound audit judgement' are always potentially possible: lack of competition,

conflicts of interest, absence of shareholder dialogue, lack of regulatory oversights, and so on – as evidenced by our analysis.

We therefore argue that systemic or institutional trust is ultimately *rooted in rituals of accountability at critical field-configuring events*. The questioners in the inquiry we have analysed opened up for debate some of the institutionalised trusting actions vis-a-vis audit. Thus, trust in audit can be repaired *only insofar as we still trust the political system of inquiries* and their recommendations. For trust transfer to take place as a result of such inquiries, “it is necessary to craft institutional arrangements, which sustain and re-build trust as social capital.” (Misztal, 1996: 214) One could argue that increasingly we live not (primarily) in the ‘Audit Society’ but in the ‘Inquiry Society’ – inquiries are indeed everywhere: the UK has recently seen Inquiries into phone hacking by the Press, editorial lapses at the BBC, parliamentarians’ expenses, the LIBOR rate scandal, and so on. For us, inquiries are a mechanism of transferring trust from one area of society where some amount of trust still exists (e.g. the legal framework or political oversight system) to where much less trust exists: many areas ranging from the banks, the Big Four, the newspapers, the BBC, politicians, parliament and so on. Trust transfer is thus potentially a crucial mechanism for the *repair of damaged legitimacy*.

### **The Future of the Audit Industry**

It has long been held that legalized norms of procedural fairness, which underlie this like other inquiries, “are the sine qua non for society-wide ‘generalized trust’” (Cohen & Arato, 1992: 27). Our ability to hold powerful privileged operators to account is the condition for our generalised ability to, under normalized conditions, *be trusting and let them function* (or get on with it). While this holding-to-account may soon be forgotten and a return to ‘business as usual’ might follow, there is also the prospect of the scrutiny becoming much more intense and semi-permanent. This could play out in a number of ways: first, we may see more of the strategies used by the Big Four in this paper to repair trust with little or no substantive change to the institutional field; second, it might lead to legislation that changes the existing political-economic settlement that has been so favourable to the Big Four firms; third, it may open up a fissure between the UK and European Union institutions over the treatment of audit firms (Quick et al., 2008). There is of course nothing inevitable about any of these courses of actions, but the House of Lords inquiry certainly marks the *start of a political-economic reformulation* of the role and status of the Big Four. The Big Four audit firms will be far from passive in this process and will undoubtedly provide fascinating glimpses into their political power. Existing

work by Anderson-Gough et al. (2000) and others (author reference, 2013) reveals the embedded nature of social relations that exist within an audit contract. In the world of familiar relations between audit partners and their clients, characterized by high levels of personal as well as system trust, a critical report from the House of Lords is likely to have little or no impact on this relationship. Outside of the UK, any impact between firms and their clients would be negligible.

It is the impact on the policy world where the House of Lords report is likely to have its greatest impact. This is a world far removed from the personal relationships between audit firms and their clients, it is one that seeks to evaluate whether the current expert system of audit is indeed what that can be trusted. There are a number of reasons why the House of Lords report stands the possibility of being influential in the long-term: (a) The subject matter was highly topical and resonated with concerns being expressed in Western Europe and in North America; (b) Members of the committee are highly regarded within the world financial infrastructure and, consequently, they have an 'authority to speak'; and (c) It is a report written from within the Parliament housed in one of the three leading world cities (Sassen, 2013) and one of the world's leading financial centres. Perhaps the greatest reason that a critique by the House of Lords on the expert system of audit in the UK is likely to be far-reaching is because accounting is highly standardized as a profession internationally. In fact, accounting could be considered to be the quintessential global profession. Standardization has occurred through the widespread diffusion of International Financial Reporting Standards, in addition to the global dominance of the Big Four accounting firms. The corollary of this is that a critique of one context (the UK audit system) is likely to apply to other contexts because of the high levels of standardization and market concentration.

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**APPENDIX – see separate document**